



August 3, 1989

Re: Property Tax; Cost Method; Energy Tax Credits

Dear Mr. Herbert:

This is in response to your letter to us dated June 19, 1989. You ask for our opinion with regard to whether assessors are justified in ignoring energy tax credits with respect to market value determinations of wind turbines by the cost approach to value.

You cite the case May Department Stores Company v. County of Los Angeles, 196 Cal. App. 3d 775, and you acknowledge that the case stands for the proposition that the assessor may disregard the federal investment tax credit (ITC) when calculating an asset's taxable value for California property tax purposes. You then say that the California energy tax credit is fundamentally different from the ITC and that May Department Stores is not controlling for the handling of such credit in the appraisal process. You say that the California energy tax credit was a special purpose credit designed to promote investment in, and to create alternative energy systems in California, and that it does not suffer from the inherent uncertainty of the ITC in that:

- (a) Once the energy tax credit is properly claimed, no repayment is possible; and,
- (b) A taxpayer cannot vary the amount of the California energy tax credit claimed.

For purposes of this opinion, we accept your description of the California energy tax credit. However, we conclude that, with the exceptions you cite, the tax credit fundamentally operates the same as the ITC in that if the owner structures a property purchase within the parameters set forth in the law, he or she will be entitled to legally reduce his or her state and federal income tax obligations.

Based upon the thrust of your letter and my telephone conversation with you on July 10, I conclude you are of the view that the energy tax credit must be taken into account by the assessor when determining fair market value by the cost approach. We cannot agree to that view of conclusion. Please let me explain.

The cost approach to value is a fundamental appraisal tool and method universally accepted within the appraisal profession. It is one of three accepted approaches to value, the other two being the income approach and the comparable sales approach. Principles of the cost approach to value are set forth in Board Rule 6 "The Reproduction and Replacement Cost Approaches to Value" (Title 18, Public and Revenue, California Code of Regulations) and in the Board adopted Assessors' Handbook, AH 501 "General Appraisal Manual" March 1975 Edition, revised September 1982, in section VIII.

"The cost of acquisition is the starting point for determining the replacement cost new less depreciation which provides the taxable or full cash value of any asset in any given year after its purchase. Replacement cost new less depreciation is computed by trending the cost of the asset for inflation, usually upwards, to arrive at a replacement cost. The replacement cost is then depreciated to arrive at a current market value. Both steps are accomplished by use of a 'fair market multiplier' or trending factor. (May Department Stores Company, *supra*, at page 766.)

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Costs for appraisal purposes may be thought of as full economic costs. Full economic costs are defined as the payments that must be made to secure the continued supply of all the agents of production (AH 501, page 55) necessary to bring the property to a finished state for sale (Rule 6b). Income tax credits are not an element of production. An income tax credit only impacts capital outlay, not market value. Market value is the exchange value a property possesses. The fact that an income tax credit is afforded does not diminish the exchange value the property possesses so it follows that the income tax credit could not diminish market value. A position that an income tax credit diminishes market value would be inconsistent with the definition of market value as set forth in section 110 of the Revenue and Taxation Code. The cost used by an appraiser to arrive at an estimate of market value is the cost of the property in terms of labor and material costs, plus all other costs to bring the property to a finished state for sale (Rule 6b) and is therefore measured in terms of net outlay after income tax credits.

We conclude the assessor is not required to consider income tax credits of any kind when determining the cost of a property when that cost is to be utilized in the determination of market value. Such cost is determined by a typical arm's-length negotiation between the seller and buyer under the conditions set forth in Revenue and Taxation code section 110. The assessor, after determining cost, is then obligated to apply good appraisal practice for the determination of a market value indicator based upon the cost of the property being appraised. Our conclusion that an income tax credit shall not be determinative of cost is not to be misconstrued to conclude that the assessor is somehow excused from applying good appraisal practice. We say only that the income tax credit does not automatically reduce market value of a property below that of a property on which an income tax credit is not taken.

The market value of wind turbines may be great or little, depending upon the value in money or moneys worth of the wind turbine property at the time of appraisal. The market value in money or moneys worth does not hinge upon whether an income tax credit is taken on the property or not. The cost of a wind turbine property when new could be a particularly strong and reliable indicator of value. However, as time passes, physical deterioration and economic or functional obsolescence could cause the wind turbine property to lose significant value. The determination of loss of value is an important element of the cost approach to value and therefore should be given serious attention by the assessor.

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. You may wish to consult the appropriate county assessor in order to confirm that the described transactions will be treated in a manner consistent with the conclusions stated above.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Yours very truly,

(Original signed by)

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cc: Mr. John W. Hagerty  
Mr. Verne Walton